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Introduction

1. Purpose and scope of this book

This book is intended to support and assist practitioners involved in the application of European competition law to mergers. Our principal intention is to provide lawyers who do not have a background in economics with an overview of the economic foundations of merger analysis, and of the analytical techniques and evidence used to appraise the competitive impact of mergers. We also hope that this book may be useful to economists who wish to gain an understanding of how economics is applied to merger assessment in practice. The goal is to assist readers to understand the economic concepts relevant to a particular case; to identify forms of economic analysis and evidence relevant to that case; to recognise what analyses and evidence would best be prepared by the merging parties and their advisers; and to evaluate critically economic evidence prepared on behalf of merging parties or by competition authorities.

In line with this goal, the book is structured according to the types of issue that particular merger notifications may raise. Each issue, and the relevant forms of evidence and analyses, is discussed on a stand-alone basis. This approach is intended to allow the text to be used as a reference, with the reader able to consult the relevant section for the type of merger or question faced.

Chapter 2 introduces the concept of **market definition**. Market definition is a conceptual framework for identifying the groups of firms, products and regions amongst which competitive interactions arise. As such, market definition is a central element of all antitrust investigations, including merger assessment, where market definition provides the starting point for investigating the impact of changes in firm ownership. Chapter 2 provides an overview of the evidence and analytical techniques used by the Commission to inform the assessment of market definition in merger investigations.

Chapter 3 discusses **unilateral effects**, a theory of harm that frequently arises in the context of **horizontal mergers**. Unilateral effects may lead to a lessening of competition where a merger brings together two firms whose products represent important substitutes for customers. Chapter 3 describes a range of considerations relevant to the assessment of unilateral effects, and surveys the various forms of evidence and analysis employed in practice to assess the scope for unilateral effects in horizontal mergers.

Chapter 4 discusses **coordinated effects**, a less common theory of harm that may apply in the case of horizontal mergers. Coordinated effects arise where a merger changes market conditions such that firms may be better able to restrict competition between themselves via a tacit understanding of their joint interest in higher prices. Chapter 4 reviews the factors that economic theory predicts might make coordinated effects more or less likely, discusses the framework established by the Commission for the practical assessment of coordinated effects, and describes the forms of evidence that have been considered by the Commission within that framework.

Finally, Chapter 5 considers **non-horizontal mergers**, which are distinguished from horizontal mergers by the fact that they do not concern products that customers would consider substitutes and therefore do not eliminate direct competitive constraints between firms. Non-horizontal mergers encompass **vertical mergers** between firms at different levels of a supply chain, and **conglomerate mergers** between firms active in different markets and different supply chains. While non-horizontal mergers will raise competition concerns less frequently than horizontal mergers, in some circumstances they may permit firms to engage in **foreclosure**, that is, behaviour that weakens rivals and consequently lessens competition. Chapter 5 discusses the various forms of foreclosure theory that may apply in non-horizontal mergers, the framework used by the Commission to assess these theories, and the types of evidence considered in such assessments.

In preparation for this material, this introduction provides an overview of the framework within which mergers are assessed in Europe, focusing on the role of economic evidence and analysis. Section 2 starts by setting out the regulatory standard for merger assessment in the European Union and the procedure by which the European Commission investigates and rules upon notified transactions. Section 3 goes on to provide an introductory discussion of the role of economics in European merger analysis, focusing on the increased usage and importance of economic analysis over the last five years.

Section 4 provides an introduction to the core economic principles that underpin merger control. It discusses the central concepts of industrial organisation, the academic field that provides the basis for economic analysis of firm behaviour and market structure. The practical application of industrial organisation theory to real-world firms and industries is the essence of the economic analysis of mergers.

Theory alone is usually not sufficient to reach a firm conclusion on the likely impact of a merger on competition. While economic theory will often provide an indication of the *direction* of relationships between variables (for instance the relationship between a product's price and demand for that product), it is generally not able to provide an indication of the *strength* of those relationships. The strength of relevant economic relationships must be assessed on an ad hoc basis for the industry and firms involved in each merger investigation using empirical evidence. This often requires the use of econometrics, a field concerned with the use of mathematics and statistics to connect economic theory with empirical data. This is the subject of Section 5, which provides a brief introduction to empirical economic evidence and its application to merger assessment.

2. Legal framework and Commission procedure

2.1 The Merger Regulation

The legal basis for the regulatory supervision of corporate mergers and acquisitions in Europe is provided by the EC Merger Regulation (the '**Merger Regulation**').[1] The Merger Regulation applies to concentrations, defined as covering 'operations bringing about a lasting change in the control of the undertakings concerned and therefore in the structure of the market', a definition that encompasses joint ventures as well as mergers and acquisitions.[2]

The Merger Regulation acknowledges that such concentrations 'are to be welcomed to the extent that they are in line with the requirements of dynamic competition and capable of increasing the competitiveness of European industry, improving the conditions of growth and raising the standard of living in the Community'.[3] However, the Merger Regulation

[1] Council Regulation (EC) No. 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), OJ L24/1, 29 January 2004.
[2] Merger Regulation, para. 20. [3] Ibid., para. 4.

also notes that mergers should be permitted only in so far as they do not 'result in lasting damage to competition', and that the European Union asserts a legal basis for 'governing those concentrations which may significantly impede effective competition in the common market or in a substantial part of it'.[4]

The Merger Regulation affords the European Commission exclusive jurisdiction over transactions that bring about 'significant structural changes, the impact of which on the market goes beyond the national borders of any one Member State'.[5] Transactions affecting individual Member States fall within the purview of the applicable national competition authorities.[6]

The Merger Regulation limits assessment by the Commission to mergers that meet specified turnover thresholds, concentrations that meet these thresholds being referred to as having a '**Community dimension**'.[7] A concentration has a Community dimension if:[8]

> (a) the combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 5 000 million; and (b) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 250 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

From an economic perspective, the most important element of the Merger Regulation is that concerning the competitive assessment of mergers. The Merger Regulation establishes the concept of a **significant impediment to effective competition ('SIEC')** as the criterion against

[4] Merger Regulation, para. 5. [5] Ibid., paras. 8 and 9. [6] Ibid., para. 8.
[7] Ibid., paras. 9 and 10.
[8] Ibid., Art. 1, para. 2. Alternatively, a concentration has a Community dimension where:

> (a) the combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 2 500 million; (b) in each of at least three Member States, the combined aggregate turnover of all the undertakings concerned is more than EUR 100 million; (c) in each of at least three Member States included for the purpose of point (b), the aggregate turnover of each of at least two of the undertakings concerned is more than EUR 25 million; and (d) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 100 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

See ibid., Art. 1, para. 3.

which concentrations are to be assessed. It provides that 'any concentration which would significantly impede effective competition, in the common market or in a substantial part of it, should be declared incompatible with the common market'.[9]

The concept of an SIEC represented a departure from the standard set out in the previous regulation governing merger control in Europe ('the 1989 Merger Regulation').[10] The 1989 Merger Regulation prohibited any concentration which 'creates or strengthens a dominant position as a result of which effective competition in the common market or in a substantial part of it would be significantly impeded'.[11]

It should be apparent that the criterion for prohibition established in the Merger Regulation is a broadening of the equivalent condition in the 1989 Merger Regulation. Both refer to a significant or substantial impediment to effective competition, but the 1989 Regulation includes an additional requirement for prohibition that a dominant position be created or strengthened that is absent from the 2004 Merger Regulation.

The dominance provision in the 1989 Regulation was held by some commentators to give rise to a 'gap', whereby the Commission would be legally prevented from prohibiting mergers with the potential to harm consumers through a lessening of competition in oligopolistic industries in which no individual firm was dominant.[12] While the Commission had, via its case law, created the concept of collective dominance with which it prohibited mergers under the 1989 Merger Regulation in industries not characterised by a single dominant firm, this concept depended on establishing scope for firms to coordinate their actions via collusive behaviour.[13] The enforcement gap was held to arise in the case of mergers taking place in markets in which there was no realistic prospect of coordinated

[9] Merger Regulation, para. 25.
[10] Council Regulation (EEC) No. 4064/89.
[11] 1989 Merger Regulation, para. 24.
[12] An oligopolistic market is one characterised by a small number of competing suppliers, such that those firms are able to influence price and take into account the behaviour of rivals when determining their own strategies (as distinct from the textbook model of pure competition, in which individual firms have no such influence but must charge the price determined by the market or make zero sales). In practice, almost all markets of interest to competition law are oligopolies.
[13] For an articulation of the view that the Commission's decision to prohibit the *Airtours/First Choice* merger on collective dominance grounds possibly represented an attempt to sidestep a lacuna in the 1989 Merger Regulation see M. Motta (1999) 'EC Merger Policy, and the Airtours case', available at http://people.exeter.ac.uk/maf206/motta_1999.pdf.

behaviour, and no single dominant firm, but nonetheless the prospect of a lessening of competition via unilateral effects.

The 2004 Merger Regulation was introduced to address this possible gap in enforcement, and comments on the concept in the following terms.[14]

> In view of the consequences that concentrations in oligopolistic market structures may have, it is all the more necessary to maintain effective competition in such markets. Many oligopolistic markets exhibit a healthy degree of competition. However, under certain circumstances, concentrations involving the elimination of important competitive constraints that the merging parties had exerted upon each other, as well as a reduction of competitive pressure on the remaining competitors, may, even in the absence of a likelihood of coordination between the members of the oligopoly, result in a significant impediment to effective competition … The notion of 'significant impediment to effective competition' … should be interpreted as extending, beyond the concept of dominance, only to the anti-competitive effects of a concentration resulting from the non-coordinated behaviour of undertakings which would not have a dominant position on the market concerned.

However, since the introduction of the new substantive test, the Commission's enforcement practice suggests that the alleged 'gap' in merger control under the dominance test was smaller than initially believed.[15] An article published in April 2006 by Lars-Hendrik Röller, former Chief Economist, and Miguel de la Mano, Deputy Chief Economist, found no horizontal merger in the sample they reviewed that was a clear cut 'gap case', although it was suggested that one vertical merger (*E.ON/MOL*)[16] might constitute a gap case that may not have been challenged under the 1989 Merger Regulation.[17]

Since then, gap features have emerged in only a very small number of cases. In particular, in *T-Mobile Austria/Tele.ring*,[18] which brought together the second and fourth largest network operators on the

[14] Merger Regulation, para. 25.

[15] See A. Lofaro and D. Ridyard, 'The Role of Economics in European Merger Control', published in N. Levy, *European Merger Control Review – A Guide to the Merger Regulation* (LexisNexis, 2011).

[16] Case COMP/M.3696 – *E.ON/MOL*, Commission decision of 21 December 2005.

[17] See L.-H. Röller and M. de la Mano, 'The Impact of the New Substantive Test in European Merger Control' (2006) 2(1) *European Competition Journal* 9.

[18] Case COMP/M.3916 – *T-Mobile Austria/Tele.ring*, Commission decision of 26 April 2006 (2007 OJ L88/44).

Austrian mobile telecommunications sector, the Commission concluded that anti-competitive effects would occur despite the fact that the merged entity would account for only one-third of the market. Similarly, in *EDF/Segebel*,[19] which involved EDF's acquisition of a majority stake in SPE, the second largest electricity operator in Belgium, the Commission required the parties to make significant divestments despite a combined share in the Belgian electricity wholesale market of only 10–20%. In both cases, the Commission considered that remedies were warranted since the proposed transactions as originally notified would have eliminated rivals whose competitive importance was significantly understated by their market shares.

2.2 *Procedure for notification and assessment*

It is beyond the scope of this book to give a complete description of merger notification and assessment under the Merger Regulation. In this section we instead seek to provide an overview of the various elements of the Commission procedure and timelines for those unfamiliar with the process.

Mergers falling under the Merger Regulation are assessed by the **Directorate-General for Competition ('DG COMP')**. The Merger Regulation establishes a system of mandatory notification for concentrations with a Community dimension, stating that:[20]

> undertakings should be obliged to give prior notification of concentrations with a Community dimension following the conclusion of the agreement, the announcement of the public bid or the acquisition of a controlling interest. Notification should also be possible where the undertakings concerned satisfy the Commission of their intention to enter into an agreement for a proposed concentration and demonstrate to the Commission that their plan for that proposed concentration is sufficiently concrete, for example on the basis of an agreement in principle, a memorandum of understanding, or a letter of intent signed by all undertakings concerned, or, in the case of a public bid, where they have publicly announced an intention to make such a bid, provided that the intended agreement or bid would result in a concentration with a Community dimension.

[19] Case COMP/M.5549 – *EDF/Segebel*, Commission decision of 12 November 2009.
[20] Merger Regulation, para. 34.

Mergers are normally notified to the Commission via a standard notification document template known as **Form CO**.[21] The purpose of the Form CO is to provide the Commission with the information concerning the transaction that it requires to conduct its competitive assessment. In particular, the Form CO calls for information about the parties and their ownership, details of the concentration, relevant internal documents, the definition of the relevant markets affected by the transaction, and the structure of and competitive conditions within those markets.

A merger notification becomes effective, setting the administrative timetable underway, on the date on which the Commission receives a Form CO that it accepts as complete. In principle, therefore, the Form CO may represent the first point of contact between the parties and the Commission. In practice, however, parties involved in transactions that may raise competition issues will often engage in **pre-notification** discussions with the Commission. During pre-notification the Commission will provide feedback on drafts of the Form CO, which allows the parties to identify areas in which further argumentation, evidence or analysis would assist in dispelling competition concerns.

Once a notification has become effective, the Commission commences a 25-working-day **Phase I** initial examination. This Phase I process may be extended to 35 days if the parties offer **commitments** (also known as remedies) aimed at addressing potential competition concerns. During this investigation the Commission must form a view on whether the transaction raises serious doubts as to its effect on competition. In order to reach such a view, the Commission will take account of information from the parties contained in the Form CO and responses to supplementary questionnaires issued during the course of the Phase I process. Importantly, the Commission will augment this material with its own **market investigation**, which will canvass the views of and collect evidence from third parties (particularly customers, but also rivals) active in the markets affected by the transaction.

Given the limited timescale, the Commission will typically not pursue detailed or sophisticated economic analyses during a Phase I investigation but instead focus on identifying and weighing the merits of potential concerns flagged by the information received from the parties and market participants. It will, nonetheless, engage with and consider detailed economic evidence and analyses put forward by the parties,

[21] The Form CO is provided as an annex to Commission Regulation (EC) No. 802/2004 implementing Council Regulation (EC) No. 139/2004.

particularly where such analyses have been discussed with the Commission during pre-notification. It is therefore feasible for parties to bring complex and sophisticated economic evidence into play during Phase I merger proceedings.

The Phase I investigation period ends in a decision under **Article 6** of the Merger Regulation. In the significant majority of cases, the Commission concludes that the transaction does not raise serious doubts, leading to an Article 6(1)(b) approval decision. Where such a finding depends on commitments offered by the parties, the Article 6(1)(b) decision will be issued in conjunction with Article 6(2), making the approval conditional on compliance with those commitments. An approval decision will close the merger assessment and permit the parties to complete the transaction.

Alternatively, if the Commission has serious doubts as to the impact of the transaction at the end of its Phase I investigation, it will issue an Article (6)(1)(c) decision, triggering a **Phase II** investigation. The basic timetable for the Phase II review is 90 working days, although this is extended to 105 working days where the parties offer commitments later than 55 days into the Phase II process, and/or may be extended by 20 working days with the agreement of the parties.

The Phase II process normally involves a detailed and evidence-intensive review of specific competition concerns identified during the Phase I process. The Phase II investigation provides sufficient time for the Commission to engage fully with detailed and sophisticated economic analyses and evidence provided by the parties, and for it to undertake its own economic analyses based on information both from the parties and its market investigation. Where third party information plays a part in the Commission's investigation there may be scope for the use of a **data room** process, whereby the parties' advisers, under suitable confidentiality conditions, are permitted to review and comment on data and analyses employed by the Commission's staff and/or provided by third parties.

The Phase II process ultimately leads to a decision as to the transaction's compatibility with competition law under **Article 8** of the Merger Regulation. Typically, the Commission will reach one of three decisions at the end of a Phase II investigation: unconditional clearance under Article 8(1); clearance subject to commitments addressing identified competition concerns under Article 8(2); or, in the case of a transaction deemed incompatible with the common market, prohibition under Article 8(3).

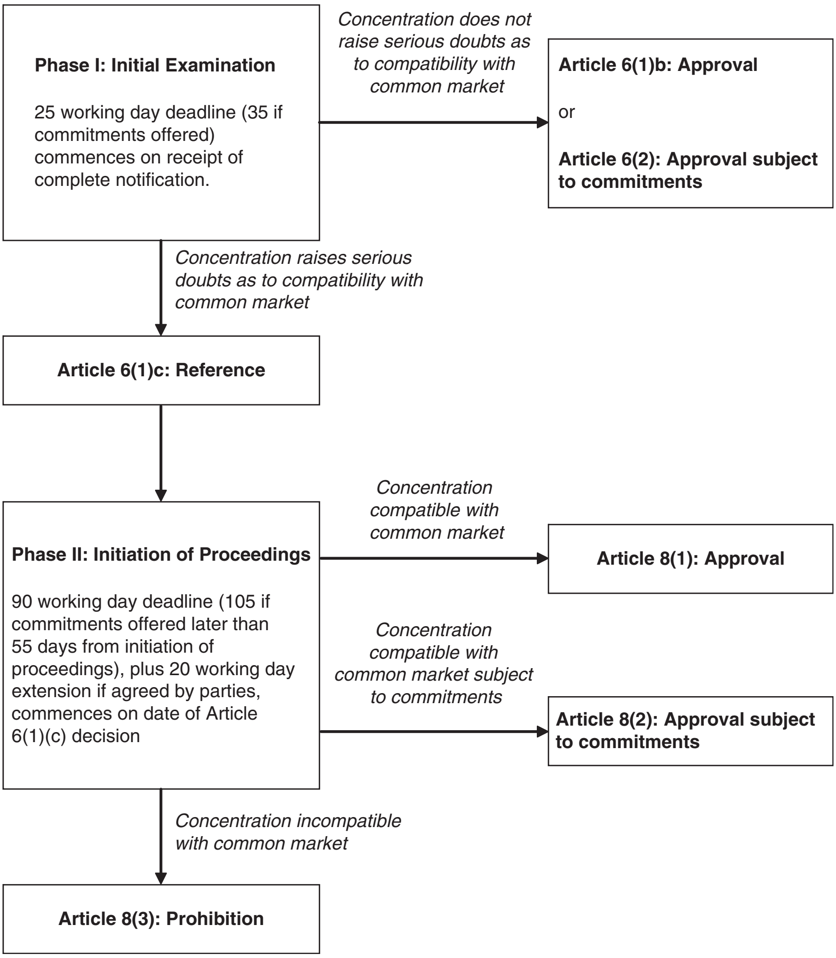

Figure 1.1 European merger review process under the Merger Regulation

Where the Commission intends to prohibit a transaction or clear it only subject to commitments, such a decision will be preceded by a **statement of objections** ('SO'), which sets out the Commission's basis for such a decision. The SO provides the parties with an opportunity to respond to the Commission's arguments prior to the decision, both in writing and at an **oral hearing**.

Figure 1.1 summarises the European merger review process under the Merger Regulation.